COMMUNICATIONS.

THE FUNCTION OF SAVING.

Böhm-Bawerk in his "Positive Theory of Capital" makes saving the primary factor in the formation of capital. I shall endeavor to show that he uses the term "saving" ambiguously, and that by so doing he reaches a false conclusion as to the function of "saving" in its proper and generally understood sense, although his conclusion is sound as regards a certain limited sense of the word.

He says (page 102): "The essential thing is that the current endowment of productive powers should not be entirely claimed for the immediate consumption of the current period, but that a portion of this endowment should be retained for the service of a future period. But such a retention will undoubtedly be called a real saving of productive powers. A saving of *productive powers*, be it noted; for productive powers, and not the goods which constitute capital, are the immediate object of saving. This is an important point, which must be strongly emphasized because, in the current view, too little consideration is given to it. Man saves consumption goods, his means of enjoyment; he thus *saves* productive powers, and with these finally he can *produce* capital."

Again (page 122): "It is not my intention to do as Senior did, and try to make Saving a third factor in production along with Nature and Labor. . . It does not share with them in the work of production in such a way that any part of the same is due to it solely and peculiarly; it only effects that the productive powers, nature and labor, which in any case must do the *whole* work of production, are directed straight to this and no other goal—the production of capital and not of consumption goods. In a word, it has its place, not among the *means* of production, but among the *motives* of production—the motives which decide the *direction* of production."

If all that is implied by the term *saving* is that it changes the *direction* of production, very little if any fault can be found with what I have so far quoted. That capital must be *produced* is a self-evident proposition. That durable capital cannot be produced if all producers expend their energies upon what Professor Böhm-Bawerk calls "present time production" (that is, goods that can be made quickly for immediate consumption) is another self-evident proposition. If the whole working population spends all its time plucking flowers, no lathes and steam engines will be made; but the entire population would pluck flowers only in the event of the wants of the entire population being limited to flowers. Whenever the wants become varied and a

portion of the population demands articles that can be produced in sufficient quantities only by means of lathes and steam engines, then lathes and steam engines (capital) will come into existence. Now if the term *saving* is to be applied only to the motives which, with a varied demand, cause certain producers to make capital, then little if any fault can be found with the contention, and also very little, if any, importance attaches to it. But he uses the term in a wholly different sense, which other sense is the generally understood one. On page 115 he says, "If every individual in the community were to consume exactly his year's income in the form of consumption goods, there would arise a demand for consumption goods which, through the agency of prices, would induce the undertakers so to regulate production that, in each year, the return of a whole year's circle of productive powers would take the form of consumption goods. . . In this case there is no productive power left to dispose of in increasing capital, and capital only remains as it was.

If, on the other hand, each individual consumes, on the average, only three-quarters of his income, and saves the rest, obviously the wish to buy, and the demand for, consumption goods will fall. Only three-fourths of the former consumption goods will find demand and sale."

It should be here noted that Professor Böhm-Bawerk supposes a very unnatural case. It is hardly conceivable that in any real society all of the members would save at the same time. Any assumption, however, is legitimate if due caution be exercised in drawing conclusions. He proceeds, "If the undertakers, however, were for some time to continue the old dispositions of production, and bring to market consumption goods to the amount of ten million labor-years (the assumed total amount before saving commenced) the over-supply would very soon press down the price, business would become unremunerative, and the pressure of loss would compel the undertakers to adapt their production to the changed circumstances of demand."

Professor Böhm-Bawerk sees clearly the effect of demand being reduced one-fourth. Undertakers would have to curtail their production. It is now time to ask how it would be possible for all the members of the community to save at the same time. What would they do with their savings? It is true all the members of a community might *hoard* at the same time, but the author is not talking about hoarding—he elsewhere (page 115) carefully distinguishes between hoarding and saving. We thus see that his assumption of all the members of the community saving one-fourth is not only unnatural but impossible. The effect of attempting it would be the curtailment of production one-fourth, but no saving could be effected if production and consumption both fell one-fourth.

Professor Böhm-Bawerk continues: "They will now provide that, in one year, only the produce of seven and one-half million labor-years is transformed into consumption goods, . . . and the two and one-half millions which remain of the current year's endowment may and will be spent in the increasing of capital."

Here is where the Professor becomes unconsciously switched from the track and henceforth goes wide astray. He draws a wholly unwarranted conclusion in stating that two and one-half millions will be spent in the increasing of capital. It is difficult to see how he could fall into this error after having done so much to show us that capital is unfinished goods. He has himself shown us that demand for consumption goods calls capital into existence. I wish to emphasize what he has taught us—we cannot put too much emphasis upon it; *demand for consumption goods is an absolutely indispensable condition for the calling into existence of capital.* Now, where, in the Professor's assumed case is the *demand* for two and one-half millions of new capital? He has assumed that all of the people have *curtailed their demand* for consumption goods one-fourth. That would throw out of use one-fourth of the capital formerly employed. All of the people are to save one-fourth, whence then comes the demand for additional capital? He attempts to explain this as follows (pp. 115–116): "I say, 'will be spent,' for an economically advanced people does not hoard, but puts out what it saves—in the purchase of valuable paper, in deposits in a bank or savings bank, in loan securities, etc. In these ways the amount saved becomes part of the productive credit; it increases the purchasing power of producers for productive purposes; it is thus the cause of an extra demand for means of production or intermediate products; and this, in the last resort, induces those who have the regulation of undertakings to invest the productive powers at their disposal in these intermediate products."

This explanation is very confused. He sees the necessity of a *demand* for the two and one-half millions of new capital and is thus led to say "that which is" saved will be spent; but under the assumed conditions the only way they could be saved would be by hoarding, as the assumption was that all of the members of the community had curtailed their demand one-fourth. How could they invest in valuable paper in a community where all of the members have curtailed their expenditures one-fourth? People who have curtailed their expenditures do not then become borrowers. If the members of the community all put their savings in a bank or savings bank, that would be hoarding, under the assumed conditions; for the bank could not loan these deposits to a community, the members of which had all curtailed their expenditures one-fourth. Granted the purchasing power of producers for productive purposes would be increased, but

such producers do not increase the production in a community where the demand has just had a uniform shrinkage of one-fourth. It is strange that Professor Böhm-Bawerk could reason out to his satisfaction how a shrinkage of demand could induce undertakers to invest the productive powers at their disposal in intermediate products as he states. Intermediate products to become what products? By whom demanded? According to the assumption, we at first had an annual production and consumption of 10,000,000, then all the members of the community reduced their demand one-fourth, thus requiring only seven and one-half millions. The capital, or intermediate products for the seven and one-half millions was already in existence, and besides the capitalists have on hand two and one-half millions of idle capital. Where is their inducement to produce new capital under those conditions?

Professor Böhm-Bawerk, on page 117, says "to every simple man it is obvious that no stock of capital can be made, or can increase if men regularly consume their whole available income, if, in other words, they do not save. It was reserved for the sharp and subtle wits of learned theorists to suggest the first doubt about it."

I ask whether the Professor has not himself fallen into the same kind of subtle theorizing that he here criticises, in his confused argument, to try to prove that sane men would borrow money and build factories and machinery as a result of a sudden resolve on the part of all the members of the community to curtail their purchases 25 per cent.

This error led Professor Böhm-Bawerk to the conclusion stated as follows (p. 116):

"We see, therefore, as a fact, an intimate connection between saving and formation of capital. If no individual saves, the people, as a whole, cannot accumulate capital, because the great consumpt of consumption goods forces the producers, by the impulse of prices, so to employ the productive powers that, every year, the produce of a whole year's endowment is demanded and used up in the shape of consumption goods, and no productive powers are left free for the increasing of capital. But if individuals save, the altered demand, again through the impulse of prices, compels the undertakers to dispose of the productive powers differently; fewer powers are put, each year, at the service of the present, and thereby is increased the amount of those productive powers whose produce will be found in suspense as intermediate products; in other words, the economical capital will be increased with a view to an increased consumption in the future."

This is wholly wrong. The fact is that "Saving," as the term is commonly understood, has no influence whatever upon the formation of capital. The amount of capital brought into existence is determined wholly by the demand for consumption goods immediately, and

mediately by the conditions which determine the general purchasing power. Any condition that raises the general purchasing power, and therefore the demand for goods, will call into existence as an incident to the production of the goods more capital. Any condition that decreases the general purchasing power, and therefore the demand for goods, will throw capital out of use and curtail its production. As the amount of capital is determined by the extent of the demand, so is the kind of capital determined by the nature of the goods demanded. If the demand for flowers, fruit and other goods of a short production period predominates, then the capital for producing goods of this kind will come into existence. If the demand for travel predominates, then more durable capital such as railroads, steamships and hotels will be produced.

What then is the real function of saving? The object of saving in the vast majority of cases is to provide a fund or income for future use, usually for the late period of life. What one saves is purchasing power, or in other words due bills upon the community's stock of goods. In actual society, instead of all people saving at the same time, as in the assumed case, some are saving and others are consuming without producing, or consuming more than they produce. Those who save lend their surplus purchasing power to those who cannot at the time save. In the case of children, invalids and some other non-producers, the purchasing power is *given* instead of loaned. In either case the purchasing power (leaving hoarding out of account) is simply transferred from the savers to other members of the community, who demand the goods that the savers might have demanded. In an ideal society free from legal monopolies, saving would not curtail demand in the least; neither would it increase demand in the least. It therefore would have no effect upon the formation of capital. Suppose that nobody saved in expectation of retiring from business voluntarily or otherwise. Suppose that all the members of the community produced all their lives, and all their lives lived up to their income. This would be the plainest possible case of a complete demand for everything produced; and if all legal monopolies could be abolished, the greatest possible amount of wealth would be produced, and the maximum amount of capital would come into existence and remain permanently. The amount of capital could not be increased one iota by such a people changing their habits in the direction of saving for future use. The only effect would be that the purchasing power of the savers would be transferred temporarily to others, in time to be returned to the savers or their heirs.

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